

1997

RUF, INC. a Utah corporation v. Icelandic Investments, Inc. : Reply Brief

Utah Court of Appeals

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**UTAH COURT OF APPEALS
BRIEF**

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DOCKET NO. 970691-CA IN THE UTAH COURT OF APPEALS

RUF, INC., a Utah corporation,)
DONALD M. DUDLEY, an individual,)
and WILLIAM GRUBER, an)
individual,)

Plaintiffs/Appellants,)

v.)

ICELANDIC INVESTMENTS, INC., a)
Utah corporation, ROBERT)
JOHNSON, an individual, and)
VR UTAH, INC. dba VR BUSINESS)
BROKERS, a Utah corporation,)

Defendants/Appellees.)

Case No. 970691-CA

Argument Priority 15

REPLY BRIEF OF APPELLANT

APPEAL FROM JUDGMENTS OF THE THIRD JUDICIAL
DISTRICT COURT OF SALT LAKE COUNTY, STATE OF UTAH
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FILED

Utah Court of Appeals

OCT 28 1998

Julia D'Alesandro
Clerk of the Court

IN THE UTAH COURT OF APPEALS

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Appellants Donald M. Dudley and Ruf, Inc. ("Buyers") respectfully submit this Reply Brief.

SUMMARY OF ARGUMENTS

The trial court erred in granting summary judgment in favor of VR Utah, Inc. d/b/a VR Business Brokers ("Broker"), and Icelandic Investment, Inc. and Robert Johnson ("Sellers") enforcing the fraudulently induced Purchase Transaction Agreement. The evidence established that both Broker and Sellers knew about yet failed to disclose the existence of the litigation pending against the entity purchased by Buyers. The evidence further established that Broker advised and persuaded Sellers to affirmatively misrepresent to Buyers that there was no pending litigation. Thus, the trial court erred in enforcing this fraudulently induced agreement and its provisions.

The trial court erred in ruling that a limited release provision contained in the fraudulently induced Purchase Transaction Agreement protected Broker from its affirmative fraudulent conduct. First, the Release provision was subject to rescission as it was contained in an admittedly fraudulently induced agreement. Second, the language of the release provision does not exculpate Broker from liability for fraudulent conduct. Finally, the release provision was void as a matter of law because public policy does not permit a covenant of immunity which will protect a person against his own fraud.

The trial court further erred in find that Buyers did not rely on the misrepresentation that there was no pending litigation

against the entity they were purchasing. Buyers' reliance was expressly contemplated, intended and acknowledged in the terms of the Purchase Transaction Agreement itself. Moreover, there was evidence that there being no litigation was extremely important to Buyers and that they would not have entered into the Purchase Transaction Agreement or signed the corresponding promissory notes if that warranty had not been made. Finally, Broker owed Buyers a duty of honesty and full disclosure which they breached when they failed to disclose (and encouraged Sellers to affirmatively misrepresent) the pending litigation. Such fraudulent omission does not require a showing of reliance under Utah law and the trial court's ruling to the contrary was error.

The trial court further erred in ruling that Buyers were not damaged by the fraud. First, as a matter of procedure, the trial court erred in relying on this basis as this issue was not raised until Broker's reply memorandum. Second, there was substantial evidence of damages incurred by Buyers, including: Buyers were damaged as the value of the entity they purchased which was subject to a lawsuit seeking in excess of \$88,000 was obviously less than the same entity with no pending litigation as represented; Buyers were damaged as they lost their funding source which was contingent on their being no pending litigation against the entity being purchased; and Buyers were damaged when they were named as parties to the pending litigation and forced to obtain representation and defend themselves in the litigation.

Finally, the trial court erred in enforcing a Default provision and finding that Sellers, having admitted making an intentional misrepresentation to induce Buyers to enter into the Purchase Transaction Agreement, were not liable to Buyers because Buyers failed to notify Sellers of their "right to cure" the default. First, the Default provision is unenforceable as it was contained in the Purchase Transaction Agreement and induced by fraud. Second, as a matter of law Sellers cannot hide behind the Default provision to protect themselves from their own fraud. Third, the language of the Default provision did not apply to misrepresentations of existing facts and, in any event, it could not be cured. Finally, even if the Default provision applied, Sellers did not cure the default within thirty (30) days as required under that provision and that is fatal to their claim.¹

In sum, the trial court erred in granting summary judgment on Buyers' claims for fraud in the inducement and negligent misrepresentation against both Sellers and Broker. Moreover, given the fraudulently induced agreement, the trial court also erred in granting summary judgment against Buyers on the counterclaims of Sellers and Broker, both of which were based on the fraudulently induced agreement. Accordingly, the trial court's rulings granting summary judgment in favor of Sellers and Broker should be reversed and the case remanded for further proceedings.

¹ The undisputed evidence established that Sellers had actual notice yet failed to terminate the litigation for more than eighteen (18) months after the parties entered into the Purchase Transaction Agreement, and more than eight (8) months after receiving Buyers' notice of rescission.

I. BROKERS' ARGUMENTS ON APPEAL ARE WITHOUT MERIT AND THE TRIAL COURT'S JUDGMENTS SHOULD BE REVERSED.

Broker makes three (3) arguments in support of the trial court's summary judgment in its favor: (1) The Release of Liability set forth in Article XX of the Purchase Transaction Agreement Is Not Subject To Rescission And Exculpates Broker From Its Misconduct; (2) Buyers failed to present evidence of reliance upon the Sellers' misrepresentation in which the Broker participated and upon the omission by Broker; and (3) Buyers failed to present evidence of damages. These arguments are addressed in turn.

1. The Release Of Liability Contained In The Fraudulently Induced Purchase Transaction Agreement Cannot Protect Broker From Its Own Misconduct And, Moreover, It Is Subject To Rescission.

The record evidence before the trial court established that at the time of the Purchase Transaction the Sellers knew about the pending Associated Factors Lawsuit and not only failed to disclose that litigation but affirmatively represented that there was no such litigation. See Brief of Appellant at pp. 3-6. The evidence further established that the Sellers discussed the existence of the Associated Factors Lawsuit with Broker yet Broker did not disclose that litigation to Buyers and, in fact, Broker persuaded Sellers not to disclose the pendency of the litigation. Id.

Broker now argues that despite the record evidence of its intentional fraudulent conduct, summary judgment in its favor was proper because of the Release provision set forth in Article XX of

the Purchase Transaction Agreement. That argument is fundamentally flawed in several respects.

A. The Release Provision Is Part And Parcel Of A Fraudulently Induced Contract That Is Subject To Rescission And, Therefore, The Release Is Void.

First of all, Broker cannot escape liability for its misconduct based on a provision set forth in a fraudulently induced agreement. Because of the material misrepresentation, the entire Purchase Transaction Agreement is voidable and subject to rescission. E.g., American Scale Mfg. Co. v. Zee, 235 P.2d 361, 363 (Utah 1951); Conder v. A.L. Williams & Assocs., Inc., 739 P.2d 634, 639 (Utah App. 1987) ("plaintiff in an action for fraud has the option to elect to rescind the transaction and recover the purchase price or to affirm the transaction and recover damages") (citing Dugan v. Jones, 615 P.2d 1239, 1247 (Utah 1980)); Perkins v. Coombs, 769 P.2d 269, 271 (Utah App. 1988) (same and noting the choice of remedy belongs to defrauded party); Mecham v. Benson, 590 P.2d 304, 307-308 (Utah 1979) (same). Under the same principles, the Release provision contained in the Purchase Transaction Agreement is also void. E.g., Lamb v. Bangard, 525 P.2d 602, 608 (Utah 1974) ("A contract limitation on damages or remedies is valid only in the absence of allegations or proof of fraud.") (citations omitted); Ong Intern. (U.S.A.) Inc. v. 11th Ave. Corp., 850 P.2d 447, 454 (Utah 1993) (releases which are part of a scheme to defraud or contained in a fraudulently induced

contract are likewise voidable).² Accordingly, the trial court erred in granting Broker's motion for summary judgment enforcing the Release provision.

B. The Release Provision Language, Even If It Was Not Void Because It Was Induced By Fraud, Does Not Encompass Broker's Fraudulent Conduct.

Second, the language of the Release provision does not exculpate Broker from its fraudulent conduct. That language as set forth in Article XX of the Purchase Transaction Agreement is as follows:

By signing this Agreement, BUYER hereby acknowledges that BUYER is relying solely on BUYER'S own inspection of the business and the representations of SELLER and not on [Broker] with regard to the prior operating history of the business, the value of the assets being purchased and all other material facts of SELLER in making this offer. BUYER acknowledges that Broker has not verified, and will not verify, the representations of SELLER and should any representations be untrue, BUYER agrees to look solely to SELLER for relief and to indemnify Broker and hold Broker harmless in connection with all losses and damages caused BUYER thereby.

Under this provision the Broker was not required to verify the representations made by the Seller and Buyers agreed not to require the Broker to do so. It does not follow, however, that because the

² Broker's reliance on this Court's opinion in Otsuka is misplaced. In Otsuka, a party raised a fraud defense to a claim based on a forbearance agreement which was entered into subsequent to the agreement induced by fraud. This Court ruled that the fraud defense must be raised against the document upon which a party is being sued. Otsuka Electronics (USA, Inc.) v. Imaging Specialists, Inc., 937 P.2d 1274, 1278-1279 (Utah App. 1997) (fraud is not defense to forbearance agreement entered into without fraud and subsequent to the fraudulently induced agreement). In the present case, however, the release agreement is set forth in the Purchase Transaction Agreement, the very agreement that was induced by fraud. Accordingly, the Release provision is subject to rescission and the trial court's summary judgment rulings to the contrary must be reversed.

Broker is not verifying the Sellers' representations that the Broker can advise and encourage Sellers to misrepresent material facts as Broker did in this case. No buyer reading this language in a purchase agreement would understand he was releasing Broker from intentional misrepresentations by the Sellers which resulted from Broker's advice and insistence. Yet the evidence establishes that is what happened here.

Moreover, the language cannot be read to relieve Broker from its duty as an agent under Utah law owed to Buyers to act honestly, ethically and competently, e.g., Dugan v. Jones, 615 P.2d 1239, 1248 (Utah 1980) (citing Elder v. Clawson, 14 Utah 2d 279, 373 P.2d 802, 805 (1962)), and a prospective buyer certainly would not read the Release provision that way.

Thus, even if the Release provision was not subject to rescission because it is contained in a fraudulently induced agreement, Broker is not relieved from liability by the Release provision contained in that agreement and summary judgment was improperly entered against Buyers.

C. The Release Provision Cannot Limit Broker's Liability For Its Misconduct.

Third, the Release provision cannot exculpate Broker from liability as a matter of public policy. The Utah Supreme Court ruled:

The law does not permit a covenant of immunity which will protect a person against his own fraud on the grounds of public policy. A contract limitation on damages or remedies is valid only in the absence of allegations or proof of fraud.

Ong Int'l (USA), Inc. v. 11th Ave. Corp., 850 P.2d 447, 452 (Utah 1993) (emphasis added) (citing Lamb v. Bangart, 525 P.2d 602, 608 (Utah 1974)).³ The law simply does not allow a party to a contract to obtain a contractual provision by fraud and then seek to hide behind the protection of the provision when challenged with the fraud. Yet the trial court expressly ruled that under the Release provision of Article XX "[Buyer] expressly relieved [Broker] of any legal duties arising from the described conduct, i.e., seller's representations or misrepresentations." [R605-606]. That ruling is directly contrary to Utah law. Thus, even if the Purchase Transaction Agreement was not subject to rescission and even if the language of the Release provision could be construed to encompass Broker's fraudulent conduct, the trial court erred in finding that the Release provision relieved Broker of liability for its own fraud or for the Sellers' fraud which Broker expressly encouraged and assisted. The trial court's order granting Broker's motion for summary judgment must be reversed.

2. There Was More Than Sufficient Evidence Of Buyers' Reliance On The Admitted Misrepresentation Regarding Pending Litigation To Defeat Summary Judgment.

Broker next argues that the Buyers did not rely on the misrepresentation that there was no pending litigation against

³ It should be noted that the Utah Supreme Court in Ong refused to enforce a broad release provision that released "any and all claims, demands, rights of action or causes of action, whether known or unknown, howsoever arising, which in any way are based upon or related to [defendant's] association with the [plaintiff]." Ong, 850 P.2d at 451. Clearly if the Court refused to relieve a party from its own fraud under such a broadly worded provision, the very narrow Release provision in the case at bar cannot relieve Broker of its liability for its misconduct.

Seller Icelandic at the time of the Purchase Transaction Agreement. The record evidence before the trial court, however, established Buyers' reliance. For instance, the parties expressly contemplated and intended such reliance. Article IX of the Purchase Transaction Agreement expressly states that:

"BUYER may rely on the same to enter into this transaction, each and all of the following: . . . That there are no known . . . litigation proceedings against SELLER, which have arisen in connection with its conduct of the business.

[R15-16] Thus, it was known by both Broker and the Sellers that Buyers were relying on the representations of Sellers that there was no known litigation. Armed with this knowledge, Broker chose to advise and persuade Sellers to not disclose the pending litigation and, moreover, despite its fiduciary obligation to Buyers, the Broker also chose not to disclose the pending litigation. Under the express language of the Purchase Transaction Agreement, therefore, the Buyers demonstrated that they relied on the misrepresentation and summary judgment was improperly granted.

In addition, there was other record evidence that the lack of outstanding litigation against Sellers was extremely important to Buyers and that they would not have entered into the Purchase Transaction Agreement or signed the promissory notes if that warranty was not in the agreement. [E.g., R4-7, 432-440, 866-867 at ¶¶ 4-6 & 12]. Moreover, it is common sense that someone purchasing a business will rely on a representation that there is no pending litigation against that entity. That conclusion is bolstered in this case by the fact that the lack of outstanding

litigation was so critical to Buyers that it was expressly addressed in the Purchase Transaction Agreement.

In spite of this clear evidence that Buyers relied on the representation that there was no litigation pending against Seller, Broker argues that the Release provision somehow precludes a finding of reliance. To the contrary, that provision bolsters Buyers' position that it relied on Sellers' misrepresentation made at Broker's behest:

. . . BUYER is relying solely on BUYER'S own inspection of the business and the representations of SELLER. . . .

That language expressly states, as does the portion of the agreement wherein the misrepresentation regarding litigation is set forth, that Buyers are relying on this representation (the false representation Brokers induced) in entering into the Purchase Transaction Agreement. Based on the foregoing, it was error for the trial court to find as a matter of law that Buyers did not rely on Sellers' misrepresentation that there was no pending litigation, which misrepresentation was expressly encouraged and assisted by Broker, and the trial court's ruling must be reversed.

Finally, under Utah law Broker can be held liable for its failure to disclose the known litigation to Buyers. Broker, as agent of Buyers, owed Buyers duties of honesty, good faith and disclosure. E.g., Dugan v. Jones, 615 P.2d 1239, 1248 (Utah 1980) (citing Elder v. Clawson, 14 Utah 2d 279, 373 P.2d 802, 805 (1962); Phillips v. JCM Dev. Corp., 666 P.2d 876, 881-882 (Utah 1983)). Despite these duties, Broker not only encouraged Seller to affirmatively misrepresent there was no pending litigation, Broker

failed to disclose the litigation to Sellers. Broker's fraudulent nondisclosure of this material fact is actionable and, as a matter of law, reliance need not be shown. E.g., First Sec. Bank of Utah N.A. v. Banberry Dev. Corp., 786 P.2d 1326, 1328 (Utah 1990) (actionable fraud based on nondisclosure requires only a showing that the omitted fact was material); McDougal v. Weed, 945 P.2d 175, 179 (Utah App. 1997) (concealment of material facts is fraudulent concealment). Thus, even if one were to disregard the record evidence of Buyers' reliance on the misrepresentation/omission, the Broker's concealment of the existence of the litigation was actionable and precluded the summary judgment entered by the trial court.

3. The Trial Court Erred In Ruling That, As A Matter Of Law, Buyers Were Not Damaged By The Fraud.

Broker next argues that the trial court's summary judgment was proper because Buyers failed to show they had been damaged as a result of the misrepresentation. That argument is flawed in several respects.

A. Broker's Summary Judgment Motion Did Not Raise The Issue Of Damages And, Therefore, It Was Error For The Trial Court To Grant Summary Judgment On That Basis.

First, the element of damages was not raised in Broker's motion for summary judgment [R382-384] or its initial memorandum supporting that motion [R385-397]; therefore, it was improper for the trial court to rule against Buyers on this element. The only element of Buyers' fraud and negligent misrepresentation claims discussed by Broker in its summary judgment motion prior to its reply was the element of reliance. [R394-396] Not only was

Broker's summary judgment motion not based on a claimed lack of damages, there was no mention of damages in the statement of facts purportedly supporting the motion. The motion clearly was based on the Release provision, not on any claimed lack of damages. Given that the damages issue was not raised and Broker set forth no evidence that Buyers were not damaged, Buyers were not obligated to produce any evidence of damages and the trial court's summary judgment ruling to the contrary is error. E.g., Utah R. Civ. P. 56(b) & (e); Parrish v. Layton City Corp., 542 P.2d 1086 (Utah 1975) (party opposing summary judgment can rest on pleadings when moving party does not support motion with affidavits); Gadd v. Olson, 685 P.2d 1041 (Utah 1984) (counter-affidavits not required when moving party does not file affidavits supporting motion).

After Buyers responded to Broker's summary judgment motion that did not raise the issue of damages, Broker's reply argued for the first time that summary judgment was proper as Buyers failed to introduce evidence of damages. A basis for summary judgment cannot be raised for the first time on reply, however, and the trial court erred in granting summary judgment on the damages issue.

B. There Was More Than Sufficient Evidence Of Damage To Buyers To Defeat The Broker's Summary Judgment Motion.

Second, there was sufficient evidence of damages to defeat the motion in any event. In opposing a summary judgment motion, it is not necessary to establish a damages claim with precision and a party need only demonstrate they can produce evidence that would reasonably support a finding in their favor on this issue. Billings v. Union Bankers Ins. Co., 819 P.2d 803, 805 (Utah 1991);

Kranz v. Holt, 819 P.2d 352, 353 & 356 (Utah 1991). Such evidence is clearly established in this case. The value of an entity being sued for more than \$88,000 (more than the purchase price agreed to by Buyers) plus punitive damages is far less than the same entity with no pending litigation. Such difference in value between the thing as represented and the thing as it actually exists are damages that clearly support fraud and negligent misrepresentation claims. E.g., Schuhman v. Green River Motel, 835 P.2d 992, 994-997 (Utah App. 1992) (rescission based on fraudulent misrepresentation proper where surroundings of entity purchased misrepresented to appear more desirable than they actually were); Ong, 850 P.2d at 453,-455 (rescission based on fraud proper where business entity as existed worth less than entity as represented); Prudential Prop. & Cas. Ins. Co. v. Mardanlou, 607 P.2d 291, 292-293 (Utah 1980) (rescission of insurance agreement proper where applicant failed to disclose material fact regarding prior insurance which changed risk to insurance company); Callister v. Millstream Assocs., Inc., 738 P.2d 662, 663-664 (Utah App. 1987) (rescission proper where property conveyed had encumbrance contrary to sellers' representation).

Buyers were further damaged as the record evidence before the trial court established that Buyers lost their funding source as a direct and proximate result of this fraud as Buyers' financing for the Purchase Transaction was contingent on there being no pending litigation against the Seller Icelandic, and when it came to light that there was pending litigation despite the representation to the

contrary, the lender withdrew future funding. [R5-7, 853-854, 864-870, 1167-1172]⁴ Further, Buyers incurred damage when, in September, 1991, Buyer Ruf, Inc. was added as a defendant in the Associated Factors Lawsuit and had to retain counsel and defend itself in that substantial litigation. [R437-438, 830, 868, 895-899] Clearly the foregoing demonstrates there was sufficient evidence of damages to preclude summary judgment even had Broker properly raised the issue in its summary judgment motion. Billings v. Union Bankers Ins. Co., 819 P.2d 803, 805 (Utah 1991); Kranz v. Holt, 819 P.2d 352, 353 & 356 (Utah 1991). Thus, the trial court's entry of summary judgment against Buyers on their fraud in the inducement claim was error.

II. SELLERS' ARGUMENTS ON APPEAL ARE WITHOUT MERIT AND THE TRIAL COURT'S JUDGMENTS SHOULD BE REVERSED.

Sellers make two (2) arguments in support of the trial court's summary judgment in their favor: (1) Buyers failed to present evidence of damages resulting from the admitted material misrepresentation; and (2) The Default provision contained in the

⁴ Broker argues that this evidence should not be considered because it was filed in response to Sellers' motion for summary judgment which was briefed subsequent to Broker's motion. This evidence is properly considered with respect to Broker's motion, however, as the court's summary judgment ruling in favor of Broker was not final and was "subject to revision at any time before the entry of judgment adjudicating all the claims and the rights and liabilities of the parties." Utah R. Civ. P. 54(b). Moreover, such evidence should have been considered in connection with Buyers' Motion for New Trial which was filed for the express purpose of having the trial court consider damages evidence which Buyers could not previously present given Broker's raising of the damages issue in its reply memorandum. Thus, this evidence should have been considered and it precludes the trial court's summary judgment rulings.

fraudulently induced Purchase Transaction Agreement was not voided by the fraud and it insulates Sellers from their fraud and bars Buyers' claims. These arguments are addressed in turn.

1. There Was More Than Sufficient Evidence Of Damage To Buyers' To Defeat Sellers' Summary Judgment Motion.

To defeat a summary judgment motion, a party need not establish a damages claim with precision. Instead, they need only demonstrate they can produce evidence that would reasonably support a finding in their favor on this issue. Billings v. Union Bankers Ins. Co., 819 P.2d 803, 805 (Utah 1991); Kranz v. Holt, 819 P.2d 352, 353 & 356 (Utah 1991). As set forth fully, supra at pp. 12-14, there was clear evidence that the Buyers were damaged as a result of the undisclosed lawsuit seeking more than \$88,000 plus punitive damages against the business being purchased. Buyers were damaged by the diminished value of the entity subjected to litigation, they were damaged when they were named as parties and forced to retain counsel and defend themselves in that litigation, and Buyers were damaged when they lost their financing for the purchase and continued operation of the business.

In response to this abundant evidence, Sellers argue that summary judgment was proper as Buyers failed to "prove a material loss of profits", citing Davis Stock Co. v. Hill, 2 Utah 2d 20, 268 P.2d 988, 989 (1954).⁵ Sellers statement of the law, however, is

⁵ Sellers repeatedly cite to evidence in support of their argument that was not part of the record before the trial court. In fact, Sellers' brief does not have a single factual cite to any record evidence before the trial court and, pursuant to Rule 24(e) of the Utah Rules of Appellate Procedure, such evidence cannot be considered on appeal.

incorrect. The Davis case involves materiality of a misrepresentation (not damages) and has absolutely no relevance to this case as it is undisputed that the misrepresentation/omission was of a material fact. It appears as though Sellers are not arguing about whether Buyers were damaged (which was clearly established by the evidence before the trial court), but argue instead that Buyers failed to show precisely the amount of those damages. As set forth above, damages need not be established with absolute certainty or precision, but only that damage has occurred. That requirement is clearly satisfied by the fact that the Buyers lost a funding source, had to hire counsel to oppose the undisclosed litigation, and received an entity embroiled in litigation which obviously was worth less than the value of the entity as represented. Such damages are sufficient as a matter of law in a fraud or negligent misrepresentation case. E.g., Schuhman, 835 P.2d at 994-997 (rescission based on fraudulent misrepresentation proper where surroundings of entity purchased misrepresented to appear more desirable than they actually were); Ong, 850 P.2d at 453,-455 (rescission based on fraud proper where business entity as existed worth less than entity as represented); Mardanlou, 601 P.2d at 292-293 (insurance agreement subject to rescission simply because insured failed to disclose prior insurance cancellation on application); Callister v. Millstream Assocs., Inc., 738 P.2d 662, 663-664 (Utah App. 1987) (rescission proper where property conveyed had encumbrance contrary to sellers' representation). Thus, summary judgment in favor of Sellers both

on Buyers' claims and against Buyers on the promissory notes was improper and should be reversed.

2. The Default Provision Did Not Apply To A Fraudulent Misrepresentation And, Even If It Did, The Undisputed Evidence Showed That Sellers Did Not Cure Default For Several Years.

Sellers' remaining argument on appeal is that the trial court properly granted summary judgment enforcing the promissory notes and against Buyers' claims under the Default provision set forth in Article VIII of the Purchase Transaction Agreement.⁶ In essence, the Sellers' logic is that a party to a contract containing a default provision can effectively make unlimited misrepresentations to induce the other party to enter into the contract so long as those misrepresentations are either undetected or cured as provided in the default provision. Such an unjust result is contrary to law and the trial court erred in finding that this Default provision was enforceable, applicable, and a bar to Buyers' claims.

A. The Default Provision Is Not Enforceable As The Agreement Was Induced By Fraud.

As a matter of law, a contract induced by a fraudulent misrepresentation of existing material fact is subject to rescission at the election of the defrauded party. E.g., American

⁶ That provision provides in pertinent part:

In the event any party to this Agreement defaults on any term or provision incorporated herein, including any provision of any Exhibit attached hereto, the non-defaulting party shall give the defaulting party a written notice requiring that such default be cured within thirty (30) days after receipt of said written notice. . . . After such period, the non-defaulting parties may take the remedies set forth in this Agreement and any attachments hereto. . . . [R15]

Scale Mfg. Co. v. Zee, 235 P.2d 361, 363 (Utah 1951); Conder v. A.L. Williams & Assocs., Inc., 739 P.2d 634, 639 (Utah Ct. App. 1987) ("plaintiff in an action for fraud has the option to elect to rescind the transaction and recover the purchase price or to affirm the transaction and recover damages") (citing Dugan v. Jones, 615 P.2d 1239, 1247 (Utah 1980)). The undisputed evidence establishes that Buyers were fraudulently induced to enter into the Purchase Transaction by Appellees' misrepresentations regarding pending litigation and that Buyers, upon learning of the fraud, immediately issued a written notice of rescission. Thus, the Purchase Transaction Agreement (including the Default provision) was voided and unenforceable.

Additionally, the Sellers sought (and the trial court obliged) the enforcement and protection of a contractual provision which was obtained by an affirmative and material misrepresentation that no litigation existed. A party to a contract cannot obtain a contractual provision by fraud and then seek to hide behind the protection of the provision when challenged with the fraud. As the Utah Supreme Court has expressly stated:

The law does not permit a covenant of immunity which will protect a person against his own fraud on the grounds of public policy. A contract limitation on damages or remedies is valid only in the absence of allegations or proof of fraud.

Ong Int'l (USA), Inc. v. 11th Ave. Corp., 850 P.2d 447, 452 (Utah 1993) (emphasis added).

B. The "Default" Could Not Be Cured And The Default Provision Is Inapplicable.

Even if the law were ignored and the obligations and limitations set forth in the Default provision were somehow enforceable, the Default provision has no application as the fraud could not be cured and the provision was obviously not intended to apply to misrepresentations made to induce the other party to enter into the agreement.⁷ The "default" was the existence of litigation against the Seller at the time of the Purchase Transaction. This default simply could not be cured -- the litigation was in existence at the time of purchase and that fact could not be changed. Moreover, to rule that the Default provision allowed Sellers an opportunity to cure their misrepresentation would emasculate the affirmative representations made in the contract.⁸ Accordingly, the Default provision allowing the cure of a default is not applicable as Sellers could not cure this defect brought about by their blatant fraud.

⁷ As the language of the Default provision indicates, the provision was only intended to apply to defaults that arose after the execution of the agreement (i.e., "[i]n the event any party to this Agreement defaults on any term or provision"). Thus, the Default provision is inapplicable.

⁸ Moreover, it would be bad public policy as recognized by the Utah Supreme Court in the Ong case. Such a ruling would allow contracting parties to make unlimited misrepresentations to induce another party to enter into an agreement and then require the defrauded party to discover the fraud, provide written notice, and then only hold the defrauder liable if they could not cure the default within a month. This result would be unjust, illogical and would eviscerate the value of any representations made in a contract.

C. The Default Provision Does Not Provide Protection For Sellers As They Had Notice Of The Default.

Even if the Default provision were enforceable and the existence of litigation was something that could be cured, the Sellers failed to cure the "default" as provided under Article VIII and summary judgment was improper. The purpose of the Default provision was to provide the defaulting party with notice so they could effectively cure the default within 30 days. The undisputed evidence in this case establishes, however, the Sellers had actual notice of the "default" (i.e., the pending litigation) at the time they signed the Purchase Transaction Agreement. Despite this actual notice the Associated Factors Lawsuit was not settled for more than a year and a half after the parties entered into the Purchase Transaction Agreement. Moreover, even if actual knowledge of the default does not satisfy the technical requirement of the Default provision, the undisputed evidence shows that on September 23, 1991 Buyers sent Sellers a written notice of rescission of the Purchase Transaction identifying the outstanding litigation as the basis. [R438, 628, 868] Clearly this letter satisfied the written notice requirement of the Default provision as it placed Sellers on notice of the default. Despite this notice, however, the Associated Factors Lawsuit was not settled until June, 1992, more than eight (8) months after the notice. Thus, even if the Default provision were somehow enforceable and the default was curable, the undisputed evidence shows that Sellers did not "cure" the default within the thirty (30) period as required under the Default provision. Such failure is fatal to Sellers' claim. Callister v.

Millstream Assocs., Inc., 738 P.2d 662, 664 (Utah App. 1987) ("Even assuming plaintiffs were entitled to additional time to clear the encumbrance, it is fatal to their position that they did not actually clear it.")⁹. Thus, the trial court's grant of summary judgment in favor of Sellers was reversible error on this basis as well.

III. THE TRIAL COURT ERRED IN DENYING BUYERS' MOTION TO AMEND TO ADD CLAIM OF RESCISSION AND MOTION FOR NEW TRIAL.

Buyers' initial Brief sets forth at pages 33-36 the reasons the trial court erred in denying Buyers' motion to amend to add a claim of rescission and motion for new trial. Nothing in Appellees' responsive briefs alters the conclusion of that analysis that neither of those motions should have been denied.¹⁰ Thus, Buyers will not burden the Court by reciting those arguments again and instead incorporates them by reference.

CONCLUSION AND RELIEF SOUGHT

The trial court erred in granting summary judgment on Buyers' claims for fraud in the inducement and negligent misrepresentation against both Sellers and Broker. Moreover, given the fraudulently induced agreement, the trial court also erred in granting summary

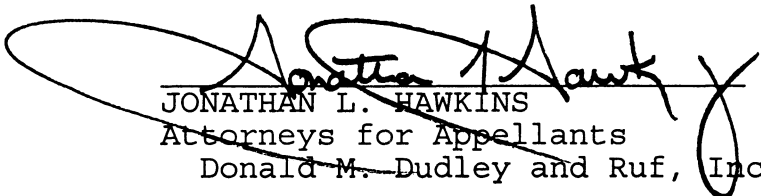
⁹ Not only did Sellers fail to cure the "default" for more than 18 months after they affirmatively misrepresented there was no pending litigation, they presented no evidence that they could cure it within the 30-days under the Default provision. Even more telling, however, is the fact that they did not terminate the litigation within the 30-day period. Thus, their reliance on the Default provision is misplaced. Id.

¹⁰ In fact, neither of the Appellees now seem to dispute that Buyers had a claim for rescission that was decided by the trial court.

judgment against Buyers on the counterclaims of Sellers and Broker, both of which were based on the fraudulently induced agreement. Accordingly, the trial court's rulings granting summary judgment in favor of Sellers and Broker should be reversed and the case remanded for further proceedings.

DATED this 28TH day of October, 1998.

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MAILING CERTIFICATE

This is to certify that two (2) copies of the foregoing REPLY BRIEF OF APPELLANT was mailed, postage prepaid, this 28TH day of October, 1998 to the following:

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A handwritten signature in black ink, appearing to read "Donald A. Hunt", is written over a horizontal line. The signature is stylized with large loops and a long horizontal stroke extending to the left.

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